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Illinois Legislature Tilts the Balance Against Lenders in Failed Construction Projects

A recent change in the Illinois Mechanics Lien Act has given contractors and subcontractors an edge against lenders in foreclosures of failed construction projects.

Previously, the Act provided that if a project failed and the foreclosure sale did not generate enough proceeds to cover both the mortgage lender and contractors holding valid and enforceable mechanics liens, the lender and the contractors had a “relative priority” (unless the contractors signed their contracts before the mortgage was recorded). Under that relative priority, the lender and the mechanic lienors would generally share sale proceeds *pro rata*, according to the value of the land at the time the mortgage was recorded and the value of the improvement constructed. However, the relative priority would shift to the lender’s favor as it funded draw requests, so that the lender would gain priority on the value of the portion of the improvement for which it paid.

The recent amendment to Section 16 of the Act changed that result: contractors who are unpaid on a project now have priority on the value of the entire improvement – even the value paid for by the lender – and are not limited to the value the unpaid contractors supplied. Thus, under the new law, as the lender funds draw requests, it does not gain a relative priority against mechanic liens but merely sets up a fund for their satisfaction. Commentary surrounding the new law indicates that it was intended to legislatively reverse *LaSalle Bank National Association v. Cypress Creek 1, LP*, 242 Ill. 2d 231 (2011), an Illinois Supreme Court decision that acknowledged the operation of the prior law.

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